

Message Text

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INFO OCT-01 EA-07 ISO-00 EB-07 COME-00 TRSE-00 OPIC-03
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L-03 H-01 SS-15 OMB-01 EPG-02 /070 W
-----092121Z 099747 /66

R 091715Z MAY 77
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC 1519
INFO AMEMBASSY CARACAS
AMEMBASSY CANBERRA
AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO
AMCONSUL BELEM

C O N F I D E N T I A L SECTION 1 OF 4 BRASILIA 3689

E.O. 11652: GDS
TAGS: EMIN, EINV, BR
SUBJ: U.S. STEEL BOWS OUT OF THE HUGE CARAJAS IRON ORE
INVESTMENT

REFS: (A) 77 BRASILIA A-136, (B) BRASILIA 9975, (C) 76
BRASILIA 5815, (D) 76 BRASILIA 5319, (E) 76 BRASILIA
3060, (F) 76 BRASILIA 2356, (G) 75 BRASILIA 10261,
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BRASILIA A-78 (CERP 0429) (ALL NOTAL)

1. SUMMARY. U.S. STEEL (USS) IS WITHDRAWING FROM THE HUGE
CARAJAS IRON ORE PROJECT IN THE AMAZON. RISING COSTS MADE THE
PROJECT LESS ATTRACTIVE. ALSO, THE GOB/USS PARTNERSHIP IN THE
CARAJAS JOINT VENTURE COMPANY HAS BEEN BLIGHTED FOR SOME TIME --
APPARENTLY CAUSING USS TO WONDER ABOUT THE POSSIBILITY OF FUTURE
DISPUTES AFTER THE CARAJAS INVESTMENT WAS UNDERTAKEN. IT IS
AN ACUTE EMBARRASSMENT TO THE GOB, IN OUR JUDGMENT, THAT
CONSTRUCTION OF CARAJAS STILL IS NOT UNDERWAY. THE
USS DECISION PROBABLY WILL SET BACK BRAZIL'S HOPE OF
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OVERTAKING AUSTRALIA AS THE FREE WORLD'S LEADING IRON
ORE PRODUCER. A LONG DELAY IN BRINGING CARAJAS ON-
STREAM COULD CONCEIVABLY INDUCE BRAZIL TO REVERSE ITS
DECISION NOT TO JOIN THE IRON ORE PRODUCERS ASSOCIATION.
THE USS DECISION IS NOT DIRECTLY RELATED TO OTHER ASPECTS
OF THE US-BRAZILIAN ECONOMIC RELATIONSHIP. NEVERTHE-
LESS, THE USS WITHDRAWAL MAY REINFORCE THE PERCEPTION

OF SOME BRAZILIANS THAT THE UNITED STATES CONTINUES TO LOSE RELATIVE IMPORTANCE AS AN ECONOMIC PARTNER OF BRAZIL. END SUMMARY.

2. ON MAY 2, THE PRESIDENT OF THE GOB-CONTROLLED MINING COMPANY CVRD, FERNANDO ROQUETTE REIS, ANNOUNCED THAT U.S. STEEL (USS) WILL NOT PARTICIPATE IN THE HUGE CARAJAS IRON ORE PROJECT. (ON MAY 4, USS REPORTEDLY ANNOUNCED ITS WITHDRAWAL.) ACCORDING TO JORNAL DO BRASIL (MAY 3), REIS SAID CVRD WOULD REAFFIRM ITS INVITATION OF PARTICIPATION TO JAPANESE STEEL COMPANIES, TO BRITISH STEEL, AND TO ALTOS HORNOS VISCAYA OF SPAIN. AS WELL, CVRD COULD EXTEND THIS INVITATION TO GERMAN, ITALIAN, FRENCH, AUSTRIAN, AND ROMANIAN COMPANIES. REIS ADDED, HOWEVER, THAT IT IS NOT OUT OF THE REALM OF POSSIBILITY THAT CVRD WOULD GO AHEAD ALONE ON THE PROJECT. REIS REPORTEDLY SAID THAT CVRD HAD THE TECHNICAL COMPETENCE TO UNDERTAKE THE PROJECT BY ITSELF, BUT THE OBSTACLE WAS RESOURCES -- THE COST OF CARAJAS TODAY WAS ON THE ORDER OF 3.5 BILLION DOLLARS. (COMMENT. THIS FIGURE INCLUDES THE COST OF THE MINE, A 900-KILOMETER RAILWAY TO THE COAST, AND A SUPERPORT CAPABLE OF HANDLING THE PROJECTED EVENTUAL PRODUCTION OF 50 MILLION TONS OF ORE PER YEAR. SOME SOURCES SAY THE COST WOULD REACH 4 BILLION DOLLARS.) ACCORDING TO JORNAL, REIS CLAIMED USS'S WITHDRAWAL WOULD NOT SET BACK THE PROJECT'S TIME-TABLE, WHICH IS CURRENT. CONSTRUCTION OF THE CARAJAS RAILWAY WILL START NEXT YEAR, HE ADDED.

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3. REIS, JORNAL REPORTED, SAID 100 MILLION DOLLARS HAD BEEN INVESTED TO DATE IN AMZA, THE CVRD/USS JOINT VENTURE ESTABLISHED TO UNDERTAKE THE CARAJAS PROJECT. REIS SAID CVRD WOULD PAY USS 50-55 MILLION DOLLARS FOR ITS 49 PERCENT EQUITY IN AMZA. THE APRIL 30 EDITION OF GAZETA MERCANTIL, HOWEVER, REPORTED THAT MINES AND ENERGY MINISTER UEKI SAID THE GOB HAD OFFERED ABOUT 60 MILLION DOLLARS TO USS. OREN HUDSON, CHIEF OF USS MINING ACTIVITIES IN BRAZIL, HAS CONFIRMED TO CONGEN RIO OFFICERS THAT AN OFFER HAS BEEN MADE TO USS AND THAT BOTH SIDES EXPECT A FINAL SETTLEMENT SOON. HUDSON SAID THAT THE CVRD OFFER UNDERSTATES USS'S OPPORTUNITY COSTS IN THE PROJECT AND ALSO DOES NOT ADEQUATELY COMPENSATE IT FOR ITS DISCOVERY OF THE CARAJAS DEPOSIT. HOWEVER, USS IS NOT PREPARED TO HAGGLE OVER THE SEPARATION TERMS AND PREFERS TO WITHDRAW FROM THE PROJECT QUICKLY AND ON AN AMICABLE BASIS, GIVEN ITS MANGANESE-MINING OPERATIONS HERE AND OTHER BROAD

INTERESTS IN BRAZIL. REIS, ACCORDING TO GAZETA, SAID THAT
LAST MONTH UEKI REACHED AGREEMENT WITH USS THAT
IT COULD REJOIN CARAJAS LATER PROVIDED THAT USS
PAID AT 50 PERCENT PENALTY ABOVE THE COST OF AMZA
STOCK IT BOUGHT.

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R 091715Z MAY 77
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4. REIS AND UEKI SEEMED CAREFUL NOT TO CRITIZE USS,
A DEPARTURE FROM THE PATTERN OF STRONGLY CRITICAL
PRESS BACKGROUNDEERS THAT CVRD OFFICIALS
HAVE GIVEN TO THE PRESS OVER THE PAST TWO YEARS.
ACCORDING TO GAZETA, UEKI CALLED THE PRESENT MOMENT
"HISTORIC" SAID BRAZIL WOULD GO AHEAD ON CARAJAS
REGARDLESS OF USS'S DECISION, BUT "MADE CLEAR THAT
THE GOVERNMENT DESIRES TO MAINTAIN A GOOD LEVEL OF
RELATIONSHIPS" WITH USS. AS AN EXAMPLE, UEKI SAID,
8 MILLION TONS PER YEAR OF CARAJAS ORE WOULD BE SOLD
TO USS. REIS, ACCORDING TO JORNAL, SAID USS WAS A
GOOD PARTNER. HE DID NOT WANT TO SPECULATE ON THE
MOTIVES FOR USS'S EXIT, BUT HE NOTED THAT THE
MAJOR PROBLEM WAS THAT USS DID NOT WANT TO INVEST
IN THE PROJECT, NOR DID IT CO-SIGN CVRD PROMISSORY
NOTES.

5. COMMENT. IT IS AN ACUTE EMBARRASSMENT TO THE GOB
THAT DEVELOPMENT OF THE VAST AND EXTREMELY RICH CARAJAS
DEPOSITS, DISCOVERED BY USS 10 YEARS AGO, STILL HAS NOT

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BEGUN. (CARAJAS CONTAINS NEAR-SURFACE DEPOSITS OF 15.7 BILLION METRIC TONS OF ORE HAVING 66.7 PERCENT IRON CONTENT, AND ANOTHER 2.1 BILLION METRIC TONS OF ORE HAVING 60.9 PERCENT IRON CONTENT.) BRAZIL HAS NURTURED HIGH HOPES FOR CARAJAS -- THAT THE PROJECT'S 50 MILLION TON PER YEAR OUTPUT WOULD ASSURE BRAZIL'S MINERALS FUTURE FOR A LONG TIME TO COME, AND WOULD HELP ESTABLISH BRAZIL AS THE SAUDIA ARABIA OF FREE WORLD IRON ORE PRODUCERS. EVEN WITHOUT CARAJAS, BRAZIL'S IRON ORE PRODUCTION HAS GROWN RAPIDLY : FROM 55.0 MILLION METRIC TONS (GROSS WEIGHT) IN 1973 TO 97.0 MILLION METRIC TONS IN 1975; AND EXPORTS : FROM 45.0 MILLION METRIC TONS IN 1973 TO 72.5 MILLION METRIC TONS IN 1975. BASED ON PRELIMINARY DATA, BRAZIL RANKED FOURTH IN 1974 AMONG MAJOR WORLD IRON ORE PRODUCERS: (1) USSR, 221.4 MILLION METRIC TONS; (2) AUSTRALIA, 95.1; (3) UNITED STATES, 84.4; (4) BRAZIL, 69.9; (5) PEOPLES REPUBLIC OF CHINA, 59.0, AND (6) CANADA, 49.2. (SOURCE: 1974 MINERALS YEARBOOK) THESE STATISTICS SUGGEST THAT BRAZILIAN HOPES MIGHT NOT BE MYOPIC: WITH CARAJAS PRODUCING 50 MILLION METRIC TONS PER YEAR, BRAZIL WOULD LEAP AHEAD OF AUSTRALIA AS THE NUMBER ONE FREE WORLD PRODUCER UNLESS AUSTRALIAN PRODUCTION WERE INCREASED SHARPLY. THEREFORE, BRAZIL WOULD SEEM TO HAVE STRONG EXPORT AND PRESTIGE REASONS FOR BRINGING CARAJAS ON-STREAM, AS WELL AS THE POLITICAL REASON OF "OPENING UP THE AMAZON." (IN HUDSON'S OPINION, THE GOB'S EAGERNESS TO MOVE FORWARD ON THE PROJECT, AT A TIME WHEN USS BELIEVES THAT A VARIETY OF PROBLEMS INCLUDING WORLD MARKET CONDITIONS DICTATED SLOW DEVELOPMENT, IS EXPLAINED BY NON-ECONOMIC REASONS.) NEVERTHELESS, THE START-UP DATE HAS SLIPPED FROM 1978 TO THE EARLY-TO-MID 1980'S, ASSUMING CONSTRUCTION BEGINS SOON.

6. WHY HAS CARAJAS BEEN STALLED FOR SO LONG? THE REASONS SEEM TO BE NUMEROUS, AND HAVE PERHAPS ONLY
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ONE COMMON THREAD -- INITIAL OVER-OPTIMISM BY THE GOB, CVRD, AND USS ABOUT THE VIABILITY OF CARAJAS IN RELATION TO ALTERNATIVE SOURCES IN BRAZIL AND ELSEWHERE (E.G., IN VENEZUELA FOR USS), AND ABOUT THE EASE WITH WHICH OBSTACLES COULD BE OVERCOME. PRINCIPAL OBSTACLES APPEAR TO HAVE BEEN:

(A) COST -- PROJECTIONS ESCALATED FROM 1.1 BILLION DOLLARS IN 1973 TO 3.5 - 4.0 BILLION DOLLARS IN 1977. OREN HUDSON COMMENTED TO US IN DECEMBER THAT CARAJAS IS NOT FINANCIALLY VIABLE. MORE RECENTLY HE COMMENTED THAT THE RATE OF RETURN ON THE INVESTMENT APPEARED TO BE LITTLE MORE THAN 8 - 10 PERCENT, OR "BANK INTEREST" AS HE CALLED IT. HUDSON ALSO SAID THE PAYOUT WOULD BE 18 - 20 YEARS, AND USS HAD TO ASSUME THAT THERE WOULD BE CONSIDERABLE CHANGE IN THE POLITICAL ENVIRONMENT DURING THAT TIME.

(B) GOB POLICY CONTROL -- WHEN THE GEISEL ADMINISTRATION ENTERED OFFICE IN 1974 IT OVERHAULED CVRD'S LEADERSHIP. THE COMPANY'S NEW PRESIDENT AND ALL BUT ONE OF THE SEVEN DIRECTORS WERE NEW TO CVRD. MORE IMPORTANTLY, THEY WERE NEW TO MINING, AND WERE MORE NATIONALISTIC THAN THEIR PREDECESSORS, WHO HAD DONE MOST OF THE PLANNING ON CARAJAS. SUBSEQUENTLY, RELATIONS BETWEEN THE CVRD AND USS PERSONNEL IN AMZA BEGAN TO DETERIORATE. ANOTHER WEAKNESS OF GOB POLICY CONTROL WAS THE APPARENT INABILITY OR UNWILLINGNESS OF PRESIDENT GEISEL AND MINES AND ENERGY MINISTER UEKI TO TAKE A DIRECT, EFFECTIVE ROLE IN TRYING TO IRON OUT CVRD-USS DIFFERENCES. IN MID-1976 FOR EXAMPLE, UEKI TOLD USS CHAIRMAN SPEER THAT THE GOB WOULD DO WHATEVER POSSIBLE TO RESOLVE OUTSTANDING ISSUES. BUT THERE IS NO INDICATION THAT UEKI'S PROMISE WAS REFLECTED IN SUBSEQUENT GOB OR CVRD ACTIONS. ALSO, PRESIDENT GEISEL DELAYED FOR A LONG TIME THE DECISION

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ON THE LOCATION OF THE CARAJAS RAILROAD, WHICH HAD BECOME A HIGHLY-CHARGED REGIONAL POLITICAL ISSUE.

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R 091715Z MAY 77

FM AMEMBASSY BRASILIA
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(C) MARKETING OUTLOOK -- USS DISAPPOINTED CVRD BY AGREEING TO BUY ONLY 8 MILLION TONS PER YEAR OF CARAJAS OUTPUT. USS TOLD US THAT IT DID NOT WANT TO BUY MORE AND THUS DEPEND EXCESSIVELY ON ONE SOURCE. USS HAD ALTERNATIVE SOURCES. USS ALSO SPECULATED THAT THE REMAINING 42 MILLION TONS PER YEAR PERHAPS COULD NOT BE PLACED ON THE WORLD MARKET IN THE TIME-FRAME EXPECTED FOR CARAJAS TO REACH FULL OUTPUT.

(D) MANAGEMENT CONTROL -- CVRD RESISTED LETTING USS REPRESENT THE INTEREST OF ALL FOREIGN PARTICIPANTS THROUGH A USS-CONTROLLED HOLDING COMPANY OWNING 49 PERCENT OF AMZA. USS ALSO SOUGHT TO CONTROL CERTAIN KEY DIRECTORSHIPS IN AMZA (E.G., FINANCIAL DIRECTORSHIP) BUT CVRD THOUGHT USS DEMANDED TOO MUCH MANAGEMENT CONTROL FOR A MINORITY PARTNER. USS ALREADY HAD ACHIEVED AN EFFECTIVE VETO POWER OVER KEY AMZA DECISIONS THROUGH REPRESENTATION ON THE BOARD OF DIRECTORS.

(E) OTHER REASONS -- THE NEW CVRD LEADERSHIP MAY HAVE
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BEEN LESS ENTHUSIASTIC THAN THE MEDICI-PERIOD LEADERSHIP ABOUT CARAJAS IN RELATION TO ALTERNATIVE INVESTMENT OPPORTUNITIES, E.G., GREATER EXPLOITATION OF CVRD'S STILL-EXTENSIVE RESERVES IN MINAS GERAIS. THE RECENT WORLD STEEL INDUSTRY SLUMP MAY HAVE DAMPENED ENTHUSIASM AND THE ABILITY OF AMZA PARTNERS TO RAISE FINANCING. EACH PARTNER AT TIMES HAS CLAIMED TO HAVE DOUBTS THAT THE OTHER PARTNER REALLY WANTED TO GO AHEAD PROMPTLY WITH CARAJAS. THE GOB HAS PRESSING REQUIREMENTS FOR FINANCIAL RESOURCES IN OTHER PRIORITY INDUSTRIES (E.G., STEEL), WHILE AT THE SAME TIME THE GOVERNMENT IS CUTTING BACK ON CAPITAL SPENDING FOR STABILIZATION POLICY REASONS. CVRD'S INEFFICIENCY AND MANAGERIAL INABILITY MAY HAVE BEEN AN OBSTACLE. NIPPON STEEL DROPPED ITS PLANNED STEEL MILL AT THE PORT OF SHIPMENT OF CARAJAS ORE. CVRD

SOUGHT TO HAVE ALL ORE SHIPPED IN BOTTOMS OF ITS OWN CHOOSING. CVRD WANTED PRIOR BANK GUARANTEES FROM AMZA'S FOREIGN PARTNERS FOR THEIR PURCHASING COMMITMENTS.

7. TAKING INTO ACCOUNT ALL THESE CONSIDERATIONS, IT IS UNDERSTANDABLE THAT THE CARAJAS VENTURE HAS STUMBLED. PARTICULARLY GIVEN THE OBSTACLES INHERENT IN THE DETERIORATED CVRD-USS RELATIONSHIP, USS PARTICIPATION IN CARAJAS COULD HAVE INVOLVED HIGHER-THAN-NORMAL POSSIBILITIES FOR DISPUTES IN THE FUTURE. USS APPARENTLY WAS, WORRIED ABOUT THIS (REF. C).

8. IF CVRD DOES NOT ATTRACT THE CAPITAL NEEDED TO ENABLE CARAJAS TO GO FORWARD AS PLANNED, THERE ARE SEVERAL LESS GRANDIOSE OPTIONS. ONE IS TO PRODUCE ONLY 12 MILLION TONS OF ORE PER YEAR, AND SHIP IT BY BARGE UP THE TOCANTINS RIVER TO BELEM. WATER TRANSPORT WOULD BE EXPENSIVE AND LESS RELIABLE. ANOTHER POSSIBILITY IS ACCELERATED EXPLOITATION OF THE MANGANESE DEPOSITS AT CARAJAS. BRAZILIAN DEPOSITS OF MANGANESE ARE LIMITED, HOWEVER, SO THE GOB MAY RESERVE THE

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CARAJAS MANGANESE FOR DOMESTIC CONSUMPTION.

9. AFTERMATH OF THE USS DECISION. THE EMBASSY HAD LONG SUSPECTED THAT A USS WITHDRAWAL FROM CARAJAS WOULD RESULT IN INTENSIFIED GOB/CVRD PUBLIC RECRIMINATIONS BLAMING USS. THE RECENT STATEMENTS BY UEKI AND REIS, HOWEVER, STRUCK A SURPRISINGLY MODERATE TONE. THE GOB MAY HAVE SEVERAL REASONS FOR MAINTAINING THIS TONE. FIRST, WITH BRAZIL'S NEED FOR FOREIGN BORROWING AND INVESTMENT SO GREAT, THE GOB MAY NOT FEEL SAFE IN LAUNCHING PUBLIC TIRADES AGAINST FOREIGN INVESTORS. SECOND, IF BRAZIL IS TO ATTRACT THE INTEREST OF OTHER FOREIGN STEEL COMPANIES IN CARAJAS, PUBLIC RECRIMINATIONS AGAINST USS WILL NOT HELP. THIRD, THE GOB PRESUMABLY STILL HOPES USS WILL BUY PART OF THE CARAJAS PRODUCTION. IT IS EVEN CONCEIVABLE THAT SOME FORM OF USS COLLABORATION IN CARAJAS MAY EVENTUALLY PROVE NECESSARY FOR CARAJAS TO GET OFF THE GROUND. WITH USS PARTICIPATION, FOREIGN COMPANIES MIGHT BE RELUCTANT TO INVEST SUBSTANTIALLY IN SUCH A LARGE PROJECT AS CARAJAS. AND IT IS HIGHLY UNLIKELY THAT THE GOB WOULD HAVE THE FINANCIAL OR MARKETING RESOURCES TO UNDERTAKE CARAJAS ALONE, DESPITE GOB/CVRD OFFICIAL BLUSTER.

10. IRON ORE PRODUCERS ASSOCIATION -- BRAZIL HAS UNTIL NOW REFUSED TO JOIN THE IRON ORE PRODUCERS ASSOCIATION, PROBABLY FOR FEAR THAT THIS STEP, WHICH WOULD SIGNAL A

POSSIBLE WILLINGNESS TO ACCEPT EXPORT CEILINGS, WOULD DETER
FOREIGN INVESTORS FROM UNDERTAKING THE CARAJAS PROJECT
AND OTHER INVESTMENTS IN BRAZIL'S IRON ORE SECTOR.
OVER A YEAR AGO, A MINES AND ENERGY MINISTRY OFFICIAL
TOLD US BRAZIL MIGHT JOIN THE ASSOCIATION IF CARAJAS
WERE DELAYED FOR TOO LONG OR WERE DEFERRED INDEFINITELY.
THE EMBASSY WOULD NOT BE SURPRISED TO SEE THE GOB MAKE
GOOD ON THE THREAT IF CARAJAS FALTERS, ALTHOUGH GOB HOPES TO
EXPAND OUTPUT IN OTHER AREAS SUCH AS MINAS GERAIS WOULD
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CONTINUE TO INHIBIT SUCH A MOVE. (THE FOREIGN MINISTRY
ALWAYS HAS FAVORED JOINING THE ASSOCIATION.)

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11. IMPLICATIONS FOR US-BRAZILIAN RELATIONS -- THE
GOB NEVER HAS SOUGHT DIRECT USG INTERVENTION WITH USS,
ALTHOUGH THERE WERE INDICATIONS LAST YEAR THAT
THE GOB HAD ENTERTAINED THE IDEA. BRAZIL DID WELL LAST
YEAR IN EUROPE AND JAPAN THROUGH GOVERNMENT-TO-GOVERNMENT
CONTACTS: PRESIDENT GEISEL BROUGHT HOME FROM HIS TRIP
TO FRANCE A COMMITMENT FOR THE TUCURUI HYDROELECTRIC
PROJECT; FROM HIS TRIP TO THE UK, A PLEDGE ON THE

ACOMINAS STEEL PROJECT; AND FROM HIS VISIT TO JAPAN,
A COMMITMENT ON THE ALBRAS ALUMINUM PROJECT. HAVING
SCORED THESE SUCCESSES, THE GEISEL ADMINISTRATION
PROBABLY THOUGHT THE USG WOULD SCRAMBLE TO INDUCE
USS TO GO FORWARD ON CARAJAS IN ORDER THAT THE
UNITED STATES WOULD NOT LOSE RELATIVE GROUND WITH
SO VALUABLE AN ECONOMIC PARTNER AS BRAZIL. THAT
DID NOT HAPPEN. KNOWLEDGABLE GOB OFFICIALS PROBABLY
RECOGNIZED THE LIMITATIONS INHERENT IN THE US GOVERN-
MENT-BUSINESS RELATIONSHIP. NEVERTHELESS, MANY
BRAZILIANS WILL SEE THE USS WITHDRAWAL AS ONE MORE
SIGN THAT, FOR VARIED REASONS, EUROPE AND JAPAN
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SEEM TO BE MORE DYNAMIC PARTNERS FOR BRAZIL THAN
IS THE UNITED STATES.
CRIMMINS

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
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Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
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Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977BRASIL03689
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
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Format: TEL
From: BRASILIA
Handling Restrictions: n/a
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Litigation History:
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Message ID: a0904698-c288-dd11-92da-001cc4696bcc
Office: ACTION ARA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 9
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 77 BRASILIA A-136, 77 BRASILIA 9975
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 16-Nov-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2603496
Secure: OPEN
Status: NATIVE
Subject: U.S. STEEL BOWS OUT OF THE HUGE CARAJAS IRON ORE INVESTMENT
TAGS: EMIN, EINV, BR, US STEEL
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/a0904698-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009